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## CITATIONS

# In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 1086

FIRST NATIONAL BANK IN HOUSTON, ET AL., PETITIONERS

*v.*

FRANK SCOFIELD, COLLECTOR OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The opinion of the District Court (R. 137–144) is reported at 62 F. Supp. 297. The opinion of the Circuit Court of Appeals (R. 151–156) is reported at 158 F. 2d 268.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 5, 1946. (R. 157.) Petition for a writ of certiorari was filed March 3, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

### QUESTION PRESENTED

Whether the taxpayer, in computing its taxable net income for the year 1937 is entitled, under Section 23 (f) or (k) of the Revenue Act of 1936, to a deduction of $150,000 by reason of its subscription in the year 1931 to a fund guaranteeing the National Bank of Commerce of Houston against loss as the liquidating agent of the Public National Bank and Trust Company of Houston.

### STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(k) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year * * *.

* * * * *

### STATEMENT

The District Court adopted (R. 138) the stipulation of facts (R. 13–51) and supplemental stipulation of facts (R. 52–55) as a portion of its findings. These facts may be summarized as follows:

In 1931, the Public National Bank and Trust Company of Houston, hereinafter called "Public", was in financial difficulties and its closing by the banking authorities appeared likely. A number of other banks and business institutions including taxpayer,[1] fearing a general business crash would follow such closing, raised an indemnity fund of $1,200,000 to be paid to the National Bank of Commerce of Houston (hereinafter called liquidator), under agreement by which it would be the liquidating agent to take over Public, assume its liabilities and liquidate it. (R. 13–14.) The taxpayer paid $150,000 into the fund under an understanding with the liquidating agent that (a) if in liquidating "you sustain losses equal to or exceeding" the fund, "then the full amount of said fund shall belong to you"; (b) if no loss or a loss of less than the guaranty fund is sustained, a pro rata refund would be made to the subscribers; (c) final settlement with subscribers would be made when the liquidation was fully completed; provided, however, that pro rata refunds would be made from time to time as, and to the extent that, the indemnity fund was in excess of the liabilities assumed. Taxpayer's board of directors was told when it approved the $150,000 payment that the entire $1,200,000 guaranty fund would be absorbed

[1] The suit was brought by First National Bank of Houston and First National Bank in Houston, as its successor. The successorship is without bearing on the issues here and reference to both banks will be as the "taxpayer."

in meeting Public's obligations and they accordingly charged the payment to the profit and loss account, and it was charged off. (R. 14–15, 20–35.)

On December 13, 1932, at the instance of the liquidator, a receiver was appointed for Public with authority to wind up its business. On February 1, 1933, the United States Comptroller of the Currency assessed Public's stockholders for full payment of their liabilities totalling $800,000 on or before March 8, 1933. Of the total amount assessed only $146,308.34 was collected by the receiver and paid to the liquidator. (R. 15–16.)

On March 29, 1933, there was due and owing the liquidator $2,964,743.25, and in May, 1933, the receiver of Public, under court authority, for the sum of $1,150,000 sold all of Public's assets except stockholders' liability, to the liquidator, which credited Public's indebtedness with that sum, leaving due $1,814,743.25. (R. 16–17.)

On December 15, 1933, it having become manifest that only a small part of the stockholders' liability assessments would be collected and that the liquidator's losses would greatly exceed the indemnity fund, the liquidator appropriated the entire amount of the guaranty fund to its own use. (R. 17.)

In the year 1933 judgments totalling $72,479.68 against 16 different stockholders of Public in suits to enforce stockholders' statutory liability were obtained; in 1934 judgments totalling $277,337.13

against 29 stockholders; in 1935 judgments totalling $2,916.47 against four stockholders; and, in 1936 judgments totalling $11,378.41 against three stockholders. (R. 17–18.)

In 1934 the liquidator received from Public's receiver on account of stockholders' liabilities, $137,295, and in 1937, $9,012.74. (R. 16.)

On August 12, 1937, the receiver of Public on a petition showing, with respect to stockholders' liabilities, that $65,006.12 of the 1933 judgments, $276,687.13 of the 1934 judgments, and all of the 1935 and 1936 judgments remained uncollected and unsatisfied, obtained an order authorizing sale of all the uncollected judgments to the liquidator for $38,003.38. (R. 18.) On November 8, 1937, the liquidator prepared a final statement showing that it had sustained a loss of $373,278 over and above the guaranty, and sent a copy to taxpayer and others. (R. 18–19.)

On March 10, 1938, taxpayer filed its income tax return for the calendar year 1937, claiming as a loss deduction the $150,000 it had paid to the fund in 1931. (R. 19.) The Commissioner of Internal Revenue disallowed the deduction and assessed a deficiency. After payment, the claim for refund was denied by the Commissioner on February 9, 1944. (R. 19–20.)

In addition to finding the facts as stipulated, the District Court made only the following findings (R. 138–139):

(b) After October 26, 1932, and until Liquidating Agent made its report (November 8, 1937), Taxpayer had no information from Liquidating Agent respecting the liquidation of Public National.

(c) After receiving Liquidating Agent's Report (November 8, 1937), Taxpayer examined it, accepted it as correct, and thereafter had no further claim for a return of its $150,000, or any part thereof, and sustained a loss of the full amount thereof.

(d) Taxpayer sustained a loss during the year 1937 and after November 8, 1937, of such sum of $150,000, which was not compensated by insurance or otherwise.

The Circuit Court of Appeals reversed. (R. 156.)

## ARGUMENT

1. The Circuit Court of Appeals held that the District Court's conclusion that the loss was sustained in 1937 "flies in the face of the undisputed facts that identifiable events, which made the loss certain, occurred many years before." (R. 156.) It accordingly reversed. The standard applied by the court below is that announced by this Court in *Boehm* v. *Commissioner,* 326 U. S. 287, where it was held that (p. 292) "a loss, to be deductible under § 23 (e), must have been sustained *in fact* during the taxable year." The District Court, however, obviously misapprehended the nature of the loss deduction. Every statement in its conclusions of law (R. 139–144) and find-

ings of fact (R. 138–139) other than that incorporating by reference the stipulation, establishes that the court believed that the loss occurred when the taxpayer was informed of the exhaustion of the guaranty fund by the final report of the liquidator. But the stipulated facts adopted as the findings of the District Court (R. 138) show without question that the loss "in fact" occurred at least several years before 1937. The District Court's decision is therefore patently erroneous under the *Boehm* decision.

The statement of the Court in the *Boehm* case that (p. 294)—

> The stipulation shows a succession of "identifiable events," occurring long before 1937, to justify the conclusion that the stock was worthless prior to the taxable year. The serious losses over a period of years, the receivership, the receivers' reports, the excess of liabilities over assets, the termination of operations and the bankruptcy sale of the assets of the principal subsidiary all lend credence to the Tax Court's judgment. * * *

coincidentally has practically equal application to the facts of this case. (R. 13–20.) Here, in addition, there were further identifiable events. For example, the unquestionably proper appropriation on December 15, 1933, of the guaranty fund to its own use by the liquidator (R. 17) established the loss in 1933, at the latest. After that date under the agreement between the tax-

payer and the liquidator (R. 31–33) there was no possibility that the taxpayer would recoup any part of its advance. Unlike the factual situation in *Boehm,* there is not even a scintilla of evidence to indicate that the loss may have in fact occurred in 1937.

In view of the circumstance that the evidence, largely stipulated and raising no question of the credibility of witnesses, is susceptible of only the conclusion that the loss occurred long before 1937, there is no conflict with the "substantial evidence" rule expressed in *Jones* v. *Commissioner,* 103 F. 2d 681 (C. C. A. 9th), and *Rhodes* v. *Commissioner,* 100 F. 2d 966 (C. C. A. 6th), as alleged in the Petition (pp. 6–7). But in any event, the *Jones* and *Rhodes* cases involved appeals from the Board of Tax Appeals where the scope of review of fact questions is more limited than appeals from the District Court. *Cf. Merrill* v. *Fahs,* 324 U. S. 308, 310. Findings of the District Court are final only if not "clearly erroneous." Rule 52 (a), Federal Rules of Civil Procedure.[2] The "clearly erroneous" test accords with the scope of review in modern equity prac-

[2] *Murray* v. *Noblesville Milling Co.*, 131 F. 2d 470 (C. C. A. 7th), certiorari denied, 318 U. S. 775; *Katz Underwear Co.* v. *United States*, 127 F. 2d 965, 966 (C. C. A. 3d), certiorari denied, 317 U. S. 655; *Equitable Life Assur. Soc.* v. *Irelan*, 123 F. 2d 462 (C. C. A. 9th); *State Farm Mut. Automobile Ins. Co.* v. *Bonacci*, 111 F. 2d 412, 415 (C. C. A. 8th); *United States* v. *Aluminum Co. of America*, 148 F. 2d 416 (C. C. A. 2d).

tice[3] which has been variously stated.[4] This Court in *District of Columbia* v. *Pace,* 320 U. S. 698, 701, approved the statement of Mr. Justice Brandeis in *Virginian Ry.* v. *United States,* 272 U. S. 658, 675, that "in equity, matters of facts as well as of law are reviewable * * *." The Court continued in its *Pace* decision that findings of fact of the trial court were presumptively correct but that this rule did not deny power to the Circuit Court of Appeals to review facts "but rather went to the weight to be accorded to the findings of a lower court and had special pertinence where credibility of witnesses was involved" (p. 702).

*Dooley* v. *Pease,* 180 U. S. 126, similarly has no application, contrary to the allegation in the Petition (p. 6), since it was decided long before this Court changed the scope of review of District Court findings of fact by ratification of the Federal Rules of Civil Procedure. In any event, since under either test of the scope of review of factual determinations the Circuit Court of Appeals was correct, there is no basis for certiorari on this issue.

2. Although the taxpayer's principal contention before both courts below was that it suffered a

[3] Notes to Federal Rules of Civil Procedure, Rule 52; Proceedings of the Institute on Federal Rules (Cleveland, Ohio, American Bar Association, 1938) 318; Proceedings of the Symposium at New York City (American Bar Association, 1938) 287; and cases cited in footnote 2.

[4] See note 3.

loss in 1937, here its emphasis is on the bad debt deduction provisions of Section 23 (k). It should be noted that the item was deducted in the return as a loss rather than as a bad debt (R. 43), and, although the claim for refund was somewhat vague, the amended complaint quite definitely sought relief only under the loss provision. (R. 7–9, 51, 63.) The District Court made neither findings of fact nor conclusion of law relating to the bad debt issue. The issue, therefore, was not properly raised. *Helvering* v. *Salvage,* 297 U. S. 106, 109. The Circuit Court of Appeals concluded that the issue had not been raised in the claim for refund but stated that in any event the contention would not aid the taxpayer since the debt was ascertained to be worthless before 1937.[5] Although there is dispute among the circuits as to whether a subjective (*Harris* v. *Commissioner,* 140 F. 2d 809 (C. C. A. 2d) or objective test of worthlessness of a debt should be applied[6] (*Avery* v. *Com-*

[5] The discussion dealing with when the loss occurred is equally applicable. If a subjective standard were applied it is significant that it was stipulated that the taxpayer's board of directors were informed on October 27, 1931, that the entire $1,200,000 guaranty fund would be "lost" in liquidating Public. (R. 34.)

[6] This controversy has been eliminated for years, beginning after 1942 by Section 124 of the Revenue Act of 1942, c. 169, 56 Stat. 798 (26 U. S. C. Supp. V, Sec. 23, changing the bad debt deduction provisions of Section 23 (k) of the Internal Revenue Code to accord with the loss provisions of Section 23 (e) and (f). *Cf. Boehm* v. *Commissioner, supra.*

*missioner,* 22 F. 2d 6 (C. C. A. 5th); *Reading Co.* v. *Commissioner,* 132 F. 2d 306 (C. C. A. 3d), certiorari denied, 318 U. S. 778), the question need not be decided here. Moreover, although we think it abundantly clear that if there were a debt, it was ascertained to be worthless before 1937 under the subjective test, Section 23 (k) is inapplicable because there never was a debt. The agreement between the taxpayer and the liquidator (R. 31–33) provided that taxpayer would be entitled to a pro rata repayment out of the guaranty fund only if the liquidator sustained a loss less than $1,200,000. Accordingly, since it was undisputed that the liquidator sustained a loss far in excess of $1,200,000 (R. 18) no obligation to repay taxpayer ever arose and hence there was no "debt" that could become worthless in any year. *McLeod* v. *Commissioner,* 19 B. T. A. 134, 139; *cf. Birdsboro Steel Foundry & Machine Co.* v. *United States,* 3 F. Supp. 640, 644 (C. Cls.). Finally, the District Court did not find that the debt was charged off in 1937, and the stipulated facts show that it was charged off in 1931 (R. 14–15, 34–35). There is, therefore, no basis for a bad debt deduction in 1937.[7]

[7] See Art 23 (k)–1 of Treasury Regulations 94 promulgated under the Revenue Act of 1936.

## CONCLUSION

The case was correctly decided by the court below, and there is no conflict of decisions. The petition should be denied.

Respectfully submitted,

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